Essays on political instability

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Chapter 6

Concluding remarks

Nowadays, the concept of political instability plays an important role in models of political economy as it is widely believed that political instability raises uncertainty with respect to future institutions and economic policies, thereby affecting the incentives of e.g., households, firms and politicians (Carmignani, 2003). This thesis has focused on the measurement, (and some of) the consequences and the causes of political instability. In particular, the research questions that are addressed in this thesis are:

- How should political instability be measured?
- Does political instability hamper economic growth?
- Do democracy and globalization in the presence of a market-dominant minority lead to ethnic violence?
- Does terrorism affect the instability of governments?

In this chapter, we present an overview of the empirical results reported in this thesis. Chapter 2 has dealt with the measurement of political instability. To that end, we have (in contrast to previous studies) used an Exploratory Factor Analysis (EFA) to examine the dimensionality of political instability. The results of the EFA are used to construct new measures for each of the identified political instability dimensions. On the basis of a set of twenty-five proxies of political instability and several test-statistics, we have found that four different dimensions of political instability can be distinguished. These dimensions are: politically motivated violence, mass civil protest, political instability *within* the political regime, and political instability *of* the political regime.

The second aim of this chapter was to examine whether political instability is related to economic growth. We have examined the impact of the four political instability dimensions on economic growth using a standard growth regression framework that is based on the work of Islam (1995). For our estimations, we have used the dynamic panel data system Generalized Method of Moments estimator of Blundell and Bond (1998). This approach takes into account the presumed endogeneity of political instability by exploiting lagged values of the political instability dimensions as instruments.

Our main conclusion is that only the instability of the political regime has a robust negative impact on economic growth – both contemporaneously as well as Granger causal. As this dimension of political instability is related to indicators such as: frequent changes of the political leader, frequent constitutional changes, frequent cabinet changes, frequent government crises, and frequent changes in the polity type, it may be concluded that this dimension comes closest to the concept economists have in mind when they build theoretical models of political instability and economic growth, in which political instability is thought to raise uncertainty with respect to future institutions and economic policies as in Svensson (1998).

We also find some evidence that more instability within the political regime is good for economic growth. This finding is in line with the conclusions of Besley et al. (2005) and Bueno de Mesquita and Root (2000) that political competition may serve as a device to appoint the most competent politician as incompetent politicians can be held accountable for the implementation of inappropriate government policies at democratic elections.

Finally, we also find some evidence for reverse causality. That is, economic growth fosters instability within the political regime, whereas the lack of growth triggers politically motivated violence. As we find that this dimension has overlap with democracy, it can be interpreted that democracy (or political competition) not only triggers economic growth, but that there are clearly feedback effects (and vice versa). The second effect is in line with results of, e.g., Miguel et al. (2004), who also use an instrumental variables set-up and find that, in Sub-Saharan Africa, economic shocks and civil conflict are related.

One of the drawbacks of the standard growth regression approach lies in the treatment of the time dimension of the data. Although panel data techniques are used to examine data over countries and years, the problem is that in order to examine long term growth, data over longer time spells should be grouped. Unfortunately, time periods chosen in panel models are often justified only on the grounds that data were available at those frequencies or the researcher wanted to divide the whole period into equal chunks. These periods are unlikely to identify information provided by the development of variables over time. If, for instance, there is a high growth rate in the beginning of the chosen period and a low growth rate in the second part of the period, the period average will be rather uninformative.

To deal with the time dimension in empirical models of economic growth, we have employed an alternative approach in chapter 3. This approach is based on the seminal work of Hausmann et al. (2005), who identify periods of rapid and accelerated growth and examine which variables may have triggered these so-called "growth accelerations".

In chapter 3, we have especially focused on the question of whether political regime changes and economic reforms trigger growth accelerations. These are periods of rapid economic growth that are sustained for at least eight years. Although our framework of analysis is based on Hausmann et al. (2005), it contains several improvements. First, we have corrected an error in the construction of the political regime change variable of Hausmann et al. (2005). It turns out that the correction of this error substantially influences the results obtained by Hausmann et al. (2005). That is, in our replication we have found that one of their main results breaks down, i.e., we find no evidence that political regime changes trigger economic growth accelerations. Our second improvement is related to the filter that is used to identify economic growth accelerations. It is reported that about forty percent of the periods identified by the filter of Hausmann et al. (2005) start either too late or too early. To improve the filter, we have suggested a simple restriction that ensures that the identified period not only features an acceleration in the long run, but also in the short run. The latter aspect is especially important, since the subsequent empirical analysis primarily focuses on changes in variables that precede economic growth accelerations. According to our modified filter, there have been 83 growth accelerations around the world as of the 1950s, which implies that, on average, every year there starts at least one growth acceleration somewhere in the world. Remarkably, these periods have not only taken place in the developed world. In fact, almost 20% (16) of all accelerations took place in Sub-Saharan Africa – the area of the world, which is mostly not associated with economic growth.

For the empirical analysis, we have tested for the appropriate panel model and conclude that, in contrast to the work of Hausmann et al. (2005), country fixed effects should be incorporated. Therefore, we have employed conditional fixed effects logistic regressions as proposed by Chamberlain (1980). Unlike Hausmann et al. (2005), we have found that economic growth accelerations are driven by economic reforms and not by political regime changes. This finding supports the view as held by the International Monetary Fund, which is summarized by the so-called Washington Consensus (see Williamson, 1994): economic freedom (and not necessarily political freedom) is important for countries to develop economically. Furthermore, there is strong evidence that the duration of political regimes is an important determinant of economic growth accelerations. That is, economic growth accelerations particularly take place in young political systems. Finally, we have found that transitions to more democracy decrease the probability that economic growth accelerates. This finding is in sharp contrast with the finding in chapter 2 that political competition positively affects economic growth.

In the second part of the thesis, we have focused on the causes of different dimensions of political instability. First, in chapter 4, we have empirically tested the theory of Chua (2003) that democracy and globalization in the presence of a market-dominant minority lead to ethnic violence. Whereas most of the literature on ethnic conflicts focuses on cross-country determinants, the theory of Chua provides an explanation why within countries violence may break out at a specific moment in time. Furthermore, in contrast to most literature that focuses on single determinants of conflict, the theory of Chua stresses the interaction of democracy, globalization, and minorities.

To examine whether the conjunction of democracy, globalization, and market-dominant minorities lead to ethnic violence, we have attempted to measure market-dominant minorities by collecting data from Chua (2003) and the Minorities at Risk data set (MAR, 2005). These proxies, in turn, are used in a fixed effects panel data model with two-way and three-way interaction effects. It can be concluded that there is no general evidence for the Chua theory. That is, in the sample that includes all countries for which we could find data, the marginal effect plots show that both democracy and globalization are insignificant in countries with a market-dominant minority. However, when we restrict our analysis to the set of Sub-Saharan African countries, there is evidence for a Chua effect. That is, in Sub-Saharan African countries, the conjunction of democracy and globalization increases ethnic violence in the presence of a market-dominant minority, while it decreases ethnic violence when a market-dominant minority is absent. These results are robust to alternative data sources for both the dependent variable and the independent variables, alternative estimation methods, alternative model specifications, attrition bias, and outliers.

The recent political turmoil (since December 2007) in Kenya is consistent with our findings. As Kenya was, until the the latest democratic elections, a relatively politically stable country, international observers believed that Kenya could be a rolemodel for the rest of Sub-Saharan Africa. However, as the political leader of the market-dominant minority President Kibaki was appointed the winner of the elections, ethnically motivated violence broke out soon after the installment of Kibaki, resulting in already more than a thousand casualties.

In chapter 5, we have focused on the question of whether terrorism is related to the stability of governments. Terrorists generally have political motives and their actions are intended to influence public opinion and political processes to enforce their demands. This notion fits in with several theories on the stability of governments, which are reviewed in this chapter. In our empirical analysis, we have focused on several questions. First, and foremost, does terrorism affect cabinet duration? Second, what is the impact of terrorism relative to other determinants of cabinet duration? Third, is there evidence for sample heterogeneity in the relation between terrorism and cabinet duration? And, finally, does terrorism influence election outcomes?

To measure terrorism, we have collected data from the MIPT terrorism knowledge base (MIPT, 2004). Our proxies relate to the incidence of terrorism, the severity of terrorism, and the type of terrorist attack. These proxies are used in two separate empirical analyses to answer the research questions.

As to the first question, we have used the method of Beck et al. (1998) in a conditional logit framework to take account of duration dependence as well as the panel dimension of the data. The modeling of duration dependence is particularly important as the probability that the current cabinet will fall may depend on the period that it is already installed. We have found some evidence that terrorism shortens the duration of cabinets – especially for more severe attacks. To go beyond statistical significance, we have compared the relative magnitude of the effect of terrorism with other determinants of cabinet duration. It is found that the impact of terrorism is larger than the impact of, e.g., economic growth or inflation, but smaller than the impact of, e.g., a government crisis or a civil war. Furthermore, we have found that the magnitude of a terrorist attack depends on the type of terrorist attack as well as the severity of the attack. We also find evidence for sample heterogeneity. That is, especially in countries with high levels of terrorism, cabinet durations are shorter. Finally, we find that terrorism not only decreases cabinet duration in general, but especially decreases the re-election probability of incumbent governments.